

Executive Compensation and Benefits Alert

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Executive Compensation Under the Tax Cuts and Jobs Act: The End of Executive Compensation As We Know It

If enacted, the newly proposed Tax Cuts and Jobs Act would effectively put an end to many of the most widely used forms of executive compensation:

- Deferred compensation and stock options would disappear.
- Use of performance-based compensation would be severely limited.
- Compensation over \$1 million to senior executive officers would be nondeductible for public companies and subject to an excise tax for tax-exempt organizations.

Of course, the tax reform bill released by the House Republicans today (November 2) is likely to change, perhaps drastically, in the coming days.

Deferred Compensation and Stock Options Eliminated

All compensation is included in income upon vesting. Only service-based vesting is recognized; performance-based vesting is disregarded.

- Stock options and equity appreciation rights are included in income upon vesting, whether or not exercised.
- SERPs and other nonqualified retirement plans are also taxed at vesting, notwithstanding that payment may not occur until many years in the future and may be subject to various conditions (including employer solvency).
- Incentive awards are included in income upon vesting, even where payment is required to be deferred for corporate governance or other reasons.
- Severance would be taxed at termination of employment, notwithstanding that it is paid over time and/or conditioned on compliance with a noncompetition covenant.
- All presently deferred compensation must be taken into income by 2026 (or if later, the year it vests).

Use of Performance-Based Compensation Limited

- Performance-based compensation is taxed when the time-based service condition is satisfied, even if performance criteria are not then met. It is not clear what happens if the amount is not then determinable.
- Performance-based compensation is no longer an exception from the \$1 million deductibility cap for proxy officers of public companies.

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Compensation Over \$1 Million Paid to Proxy Officers of Public Companies Is Not Deductible and Is Subject to 20 Percent Excise Tax if Paid by a Tax-Exempt Organization

- Public companies will not be able to deduct compensation in excess of \$1 million paid in one year to any proxy officer, even if the compensation is performance-based.
- The \$1 million deductibility cap continues to apply indefinitely to any employee who was a proxy officer at any time.
- Tax-exempt organizations are subject to a 20 percent excise tax on any compensation over \$1 million paid to its current or former five highest-paid employees.

Other Compensation Rule Changes

The proposed legislation contains numerous other amendments affecting employee benefits, including repeal of or reduced limitations applicable to:

- income exclusion for housing and meals provided to employees for the employer's convenience.
- annual income exclusion for dependent care assistance provided to employees and the employer credit related to childcare provided to employees.
- income exclusion related to employer reimbursed or paid for moving expenses.
- certain other employee fringe benefits and the deduction for business meals and business entertainment.